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Dear All

Proposals for a Future System Operator role

The Flexible Generators Group (FGG) represents the owners of and investors in small scale, flexible generation. These power stations are embedded in distribution networks and provide a variety of vital services to the system operator to help it deliver secure, economic supplies to electricity customers. We also participate in the Capacity Market (CM) and have made significant investment in new capacity on the back of CM agreements. The performance of the ESO is critical to our businesses and we welcome the opportunity to respond to this consultation.

Introduction

FGG members support the principle of full separation of the ESO into a new FSO. However, we are concerned that this work may detract from other changes to the market that are needed, and that can only be delivered by NGESO. For example, the way that NGESO despatches smaller plants compared to larger plants need to be examined, the time taken to join the BM, a system wide platform for national and regional ancillary services is needed, and changes to contracts like the BEGA should be progressed. The work on ESO separation detracted from other code changes previously and we are not convinced further delays on some of these key developments is necessarily useful.

There is much in the Ofgem/BEIS consultation that we welcome and some of those changes could be achieved without wider changes to the legal structure. FGG therefore suggest that the work in divided into discreet activities to allow more incremental changes to achieve the desired outcome.

1. Do you agree that net zero will create the need for new technical roles in the electricity and gas systems, and require a new approach to energy system governance?

There are significant changes occurring in the energy market and a review of the roles of NGESO is welcomed. However, it is not obvious that full separation is needed rather than it is desirable. BEIS and Ofgem have identified no actual incidences of there being any discrimination, just a perception.

FGG would say that the role of NGESO should be focussed on running the market and giving advice to policy makers on generation requirements, investments needed in networks, etc. Whether it does this in a totally new and separate entity does not seem necessary, though desirable, but its governance must be transparent and its interactions with all parties (including other parts of NG) done in a non-discriminatory manner.

What we would like to see is the governance roles that the ESO currently carries out taken away from them, both the role of code administrator, for CUSC and Grid Code, and its role as the EMR Delivery Body (DB). We believe that there have been clear examples of the code administrator role being used by NGESO to thwart, or slow, change to the codes when it does not want them (i.e. GC109). It has also been very poor in performing its role as DB and if they are to have a new job as FSO then removing this, rather peripheral activity, for them would be sensible and could support more efficient code governance.

2. Do you agree that the establishment of a Future System Operator is needed to fulfil the kinds of technical roles needed to drive net zero?

There is a difficult balance between the role of an FSO in informing decision making and allowing them the flexibility to lead on policy. For example, we support an FSO identifying where generation needs to be located, the types of generation needing to be built to meet net zero, etc., but it is for Ofgem and/or BEIS to direct that the FSO (or DNOs, or TOs) acts on the advice given.

In the same way that the PTE reviews the methodology behind the ECR, it would also be advisable to have some checks or user groups that look at the way the modelling is done for advice that could lead to substantial spend by UK energy customers. There also needs to be stakeholder engagement, as the FSO may want a lot of storage for example, but will not know as much about the technical developments in the storage market, though parties in that market will. The parties need to work together to achieve the changes that we need in the timescales Government policy wants.

3. Do you agree that a Future System Operator should have roles in both the electricity and gas systems?

Yes, this would seem sensible. What we also need to see is a very clear operating procedure in place between the gas and electricity control centres for dealing with things like a gas deficit emergency, where the ESO may request certain gas plant is kept on and the GSO agrees. How this works and the communications between the SOs need to be transparent and understood by the impacted parties.

4. Do you agree that a Future System Operator should be entirely separate from National Grid plc?

No. This is desirable, but not necessary. It could just be made into an unconsolidated subsidiary, as Elexon is.

Our concern is just the amount of time and effort that went into achieving the current ESO separation at a time when the market has a lot of other changes it needs to make. The separation code changes took up a lot of industry time and effort, which we do not have time to repeat, and slowed other changes that had the potential to deliver greater benefits. However, there could be further mitigations, for example the ESO offices should be moved away from NG's office so that the staff are less likely to all be in the same pub of an evening, etc.

5. What issues are there with existing institutional arrangements in the UK energy system in relation to system-wide decision-making and planning?

One of the key barriers has been the "Open Networks Project" which has made very slow progress on making a GB wide market. The role of GB ESO needs to be given to the FSO who can then lead on the development of a single market platform for both national and local ancillary services, a standard contract that applies to services bought by the ESO and the DNOs, coordinate despatch

where plants provide services to both the FSO and DSO, etc. For too long the DNOs have been creating policy behind close doors and too much time has been wasted.

The market would also benefit from a bit more command and control. For example, if the FSO says that there is a need to build generation near London, then Ofgem should be able to instruct that the transmission capacity is built by the TO and local DNO so parties can connect new assets there. At the current time the system is running with multiple, very expensive, constraints and new projects are having to locate where there is capacity and not where the system may need them. We note that the South West and South Wales have been constrained for over 15 years and recently the South East constraints have been constraining interconnectors. The time to deliver transmission capacity is a major concern and not one we think early competition is likely to help.

IT systems have also created market access issues. The EBS system was never fully delivered by the ESO and we maintain that they continue to use less smaller plant for balancing than they should, given its price and flexibility. While their progress on a single market platform is to be welcomed, we have concerns that the ESO is not good at delivering IT and needs to be incentivised to improve if the market is going to accommodate intermittent renewables, smaller parties, more DSR, etc. The time taken to register our plant into the BM is a huge concern. It is not clear that a new FSO will be any better at IT projects than the current organisational structure.

Another barrier has been cross codes developments. As noted above we believe the ESO has not been a good code administrator, as evidenced in Ofgem's Code Administrator Survey each year. FGG would support the BSC and CUSC being moved into a wholesale code, administered by another party. The D Code and Grid Code could also be merged, etc. These governance issues need to be addressed as part of Ofgem and BEIS's work on governance reform.

6. What examples/case studies are you aware of where net zero delivery in one part of the energy system did not adequately account for cross-system impacts or costs?

The inclusion of smaller parties into the wholesale market has been a major problem. The requirements are onerous and getting the new API in took a very long time. There was no effort to review the codes and check that the obligations put on smaller parties joining the BM were appropriate, leading a number of smaller changes when a SCR style of approach could have been better. Further the smaller parties have pointed out that the contracts, such as the BEGA, are not fit for purpose and code obligations are unclear.

Most smaller parties are not code signatories so have been unable to progress changes. They also do not have the staff to attend many meetings on such code changes. There has therefore been little or slow progress in addressing these market access issues.

7. Where should government focus in our efforts to improve systems thinking and coordination across the energy system?

FGG supports the Government giving the ESO the role of whole system planner, policy advisor, and data publisher. However, they also need to more fully separated from the other NG businesses, stopping share incentive schemes or other benefits that could create issues around discrimination.

The documents that NGEN produce now all look at the transmission network. An FSO needs to start considering the details of the DNO systems by region, taking a whole market view. For example, they should know the actual demand by region, the actual generation by DNO, the amount

of EV charging and smart meters, etc. A holistic market view will make it easier for policy makers to take informed decisions and also advise local authorities on things like a desire to have no more solar in one region or more wind in another, etc. At the moment the analysis is too TO focussed.

8. Do you agree that the FSO should undertake all the existing roles and functions of NGESO? If not, please explain why.

The FSO should be stripped down to core functions to focus on the development of the electricity and gas markets. NGESO should not therefore be involved in running codes, the CM or CfDs. Given their poor performance in all of Ofgem's code administrator surveys, these activities need to be moved to another body.

On transparency and data, there would be a benefit in all of the data published by the ESO, TOs and DNOs (along with other bodies like Elexon) being put into one centralised energy data portal. Often data is difficult to find and kept in different formats, some requiring passwords, etc. The work that BEIS is doing on energy data transparency should inform this.

It seems slightly odd that NGESO does the charging for all the TO and OFTO owners, but this was a policy decision made years ago and does seem to work. However, it is not obvious that they add value to the connections work of the TOs. Going via the ESO to talk to the TO seems to add cost and complexity to the process. While connection terms can be standard and the ESO involved in defining the mandatory services a plant must provide, the resolution of the technical connection issues needs to be between the generator and the TO they are connecting to. Interestingly, in our experience, NG's TO business seems to keep NGESO more involved than the Scottish TO companies do.

9. Do you agree there is a case for the FSO to undertake the long-term strategic functions outlined in Option 1? Please elaborate and provide any views on the functions we have outlined in Option 1.

FGG are not as familiar with the gas SO as the ESO. However, the roles defined covering gas seems to sensibly sit with those on the power side. The questions we would have are:

- If the FSO does gas forecasting are these staff within the gas SO function now or will they need to be moved from elsewhere in NG as it will be important not to lose expertise?
- In terms of network panning, unlike power, the focus seems to be on using less gas or redeploying gas assets to capture carbon or deliver hydrogen, are the FSO well equipped to do this or are the gas network engineers better placed? and
- They should not be taking on governance roles in gas (the Joint Office should do that), sticking to strategic advice, but not leading on policy.

10. Do you agree that there is not currently a case for the FSO to undertake all GSO roles and functions, including real-time gas system operation, as outlined in Option 2? If you do not agree, please explain why.

Again we would question what an FSO brings to the connection process on top of the network that the party is connecting to? FGG does not believe that the FSO should lead on any code management and change functions as it is conflicted as the FSO with the contents of the energy codes.

In electricity the charging covers revenue collection for a variety of parties and the charging methodology sits within the CUSC. FGG therefore propose that the role of charging moves with the CUSC to another, separate code administrator. This would remove all conflict interest in relation to charging changes, etc. It would also more closely align with the way the gas market operates, where the system operator is not in charge of gas charging. As all CUSC signatories will be BSC signatories,

we feel this should all be moved under the scope of Elexon's business and when time and resources allow, the BSC and CSUC can be merged.

11. Do you have views on the proposal for an advisory role? What organisations do you consider would benefit from the provision of advice by the FSO? Who should bear the costs of providing that advice?

We agree that more market wide analysis by the FSO would be of benefit to organisation that are related to or inform the energy policy framework, such as the CCC and HMT. As noted above, FGG believes that more micro analysis, covering the DNOs would also be important in informing future investments and operational changes. However, some of the reports that NGESO currently produce could be streamlined or combined, as there are an awful lot of them.

There should be an allowed revenue under the ESO's price control to cover the costs of the reports as they should be of benefit to all customers in the longer term. We would not support the FSO being allowed to undertake specific pieces of analysis for private organisations as this is likely to distract from their core work. FGG has always found the ESO's forecasting useful and they have been open to comments on their reports and forecasts.

If the FSO were to be required to respond to all third-party requests, even for a fee, that would seem likely to put them in a difficult position competing, with undue advantage, against other forecasters and consultants in the energy market. However, they could take feedback from third parties on the way they develop publications such as the FES. Both Ofgem and BEIS will still have powers to request additional information from them.

12. Do you have any views on the other areas where we are considering new and enhanced roles and functions for the FSO (outlined in section 3.2)?

FGG does not believe that it is appropriate for the FSO to undertake disputes resolution, as they may well be the subject of the dispute. It is Ofgem's role as the regulator to hold parties to account under their licences, codes, etc. and they should therefore be the party that hears disputes. Ofgem also has the ability to levy fines, such as for breach of licence so disputes sit far more comfortably with them.

There is no evidence that the FSO would be equipped to be a good disputes body or have a robust legal framework for the role. If a party disagreed with them, would they have a right to Judicially Review their decision, as they could Ofgem? Or would parties be able to appeal an FSO decision to Ofgem and then JR Ofgem? FGG notes that Ofgem refers to the DB's disputes role under the CM. In 2019/20 Ofgem awarded the DB no money under its disputes incentive due to poor performance and in 20/21 was still overturning the DB's decisions.

On system planning, FGG would suggest that the FSO could be in a good position to advise where investment would be needed or could deliver the greatest benefit, in terms of generation location, etc. However, it should be for Ofgem to decide whether that investment goes ahead as it will be within their gift to put the new assets, set allowed revenues, etc. all under the price control framework of the parties delivering that investment.

Competition in network development is already under way with the pathfinders. FGG has concerns that there have been delays in these projects and that the wider competition process (under the early competition project) could result in quite a slow investment delivery process.

FGG does not support the FSO taking on wider market design roles, least of all any of the roles of BEIS and Ofgem under the CM. Were the CM to be run by a more efficient code manager then maybe they could take on other roles, but NGESO has simply not been a good enough administrator to let them take on any other roles. However, the FSO would be well placed to lead market wide debate on changes to policy that may be needed, as they have been doing under their net zero market design work. This is a very collaborative approach and aims to harness the expertise in the whole market, which is more likely to lead to robust policy recommendations.

As noted above, we fully support the FSO taking a coordination role over the DNOs. They are going to be a barrier to achieving net zero unless they can be coaxed into more action a slightly quicker pace. Likewise, coordinating a central, transparent data provision framework would be welcomed.

In terms of expansion into both heat and transport, we can see the logic in heat, but not transport. It is not clear exactly what type of role the FSO would have. FGG expects that the DNOs are the ones who need to monitor the uptake of heat pumps and EVs and what they may mean for the wider energy market framework. Likewise, there seem to be a peripheral role on hydrogen and CCUS where the gas network becomes part of the delivery network or the conversion of power stations alters the way that they operate. It will be important not to swamp the FSO with too many new roles and to get them to focus on the wholesale markets if timely change is to be achieved.

FGG does not support the FSO being the strategic policy body or running any of the industry codes. We have discussed our views in more details in our submission to the code governance review.

13. What are your views on our proposed characteristics and attributes of a future system operator and how the models presented would deliver against them? Are there other characteristics or attributes that we have not yet considered?

FGG agrees with the characteristics we would all like to see in the FSO. However, we believe that delivering this is more difficult and note that the price control process also risks being very complex with too many incentives which could limit the delivery of the attributes outlined.

We note that one of the problems that the ESO suffers from is that it persistently moves staff around. While this is great for staff development, it does mean that market players often have to explain the same things to multiple staff over the years. The FSO would therefore benefit from finding a better way to develop their staff without them all moving jobs every 6 months.

FGG also still has concerns about the FSO's ability to deliver IT systems. It has a very poor record on this and it is not obvious that it is going to improve by virtue of being a different, independent body.

14. Are we considering the right organisation models for the FSO? And why?

An alternative model would be to make it an unconsolidated subsidiary of NG financed by the industry. This would be a similar model to the way Elexon works, which seems to have a total independence from NG. This may be quicker and easier to achieve than the two models outlined.

It is not clear how the NG shareholders will be compensated if the FSO becomes a public body. If it becomes a new private body then NG will need to run a sales process. How that is run will need some consideration. Every energy company may have an interest in doing DD on the ESO as it may give them access to data and information that would be useful in progressing their own business

interests. FGG are concerned that these structural changes are easy to define at a high level, but far more difficult to implement

15. Are we considering the right elements for the FSO's regulatory and accountability frameworks? And why?

Yes, but the devil is in the detail. It will be difficult to price control an asset light company. As noted above, FGG have concerns over the incentive regime and the amount of reporting between FSO and Ofgem to allow for monitoring them. We would favour a far simpler regime.

16. Do you have views on the level of shareholding or control involving other 'energy interests' and the FSO at which a conflict of interest would become a concern?

The FSO staff should have no direct interest in energy companies, including via their pensions. We suspect that this will be difficult to unravel as both the gas and power employees will have pensions under the NG company scheme.

Likewise if this is a private company it should not have to respond to a shareholder interest in the way a normal company would. Limiting a shareholding to [10%] or not allowing any "controlling interest" should be considered.

17. Are we considering the right implications of our proposals for Elexon and Xoserve?

These two bodies do need to be considered, but could each become an unconsolidated subsidiary of NG rather than the FSO?

18. What is your view on the preferred implementation approach? Please explain why.

FGG note that the implementation approach has no timetable, which therefore makes comment difficult. As noted, FGG has concerns that the full separation mode will detract from the other work that both the FSO and other parties have to do. The current ESO separation delayed CUSC and changes, created significant work for the whole market and we suspect also created internal issues for NGESO. We note that the original plan was that they would do gas as well, but that was subsequently pulled. It would be useful to know what lessons have been learnt from that process that could make further separation smoother.

FGG would propose that the work plan needs to divide the work into more manageable pieces. For example there is no reason that the FSO could not implement a coordination role over the DNOs by a mod to the STC or CUSC, requiring them monopolies to work together on certain areas, share data, etc. Removal of their code governance role can also be done under the code review work, and changing energy data transparency under the BEIS work, etc.

It would appear that the legislative and licence changes are likely to take the most time, so BEIS and Ofgem need to identify what the changes are needed for and see what incremental changes can be made before then. Legislative changes are also likely to cover other areas such as licencing of other parties, so its progress may take longer than if it just focussed on the ESO.

19. Based on the areas where we are considering new and enhanced roles and functions for the FSO, which of these should be prioritised for development? Please explain why.

There are some quick wins that could be achieved, such as expanding modelling into the DNOs regions and getting the ESO to lead on the Open Networks project to get quicker change. FGG

would like to see the ESO's role in code governance addressed as a matter of some urgency as we believe it is a barrier to progress.

20. What do you believe are the risks to implementation? How can these be mitigated?

FGG are concerned that full separation and change on the scale envisaged could result in a failure to deliver other changes that will have a more direct impact on achieving net zero. The ESO separation clearly impacted the progress on some code changes, though that may be avoided if the FSO is not a code administrator so there is less prioritisation.

Any sales or separation process also risks adding complexity to the market, needing new boards, reporting, etc. Legislation would be required to nationalise the FSO and compensation agreed with the shareholders.

While we would like to see all of the FSO staff having no direct interest in other energy companies, there is a risk that restructuring may lose the expertise within the FSO. Likewise, if they significantly expand their activities they may take a lot of staff from other local energy companies.

21. Do you have any comments on potential implications of implementation for you, your organisation, or other stakeholders?

This is an opportunity to make the FSO more of a neutral, central party that can help us progress market changes. However, where we have contracts with the ESO, DNOs, etc. how these move with company changes need to be considered.

FGG are also concerned about the need to monitor all the code changes, etc. to accommodate a full separation. Any changes to the incentives could also impact our businesses. However, at the moment the proposals are too high level to know what the direct impacts will be.

22. What is your view on the position there are likely to be cost savings across the energy system from an increased "whole system" view, as described in paragraphs 47-52 of the IA? If so, is the potential magnitude of savings illustrated fairly in the IA? If not, why not?

The analysis needs some refinement once a more detailed model of the FSO is developed. We are concerned the cost of separation is too low, but agree there should be benefits from whole system planning, if it really is whole system.

23. What is your view on the conclusion that policy intervention is likely to increase the benefits of onshore electricity network competition, as described in paragraphs 53-59 of the IA? If you agree, is the potential magnitude of savings illustrated fairly in the IA? If not, why not?

FGG fully support the pathfinder projects. However, we are concerned that the competition to deliver more transmission assets could slow the rate of delivery and add to transaction costs. The GB market desperately needs additional capacity, illustrated by the substantial costs of managing constraints (+£10m/day) and the limited scope to connect in the DNOs as well. It should therefore be a priority to get capacity in place as quickly as possible.

24. Do you think that the impact assessment has identified and considered the key costs and benefits of policy intervention? If not, can you provide details on other impacts that have not been considered?

At a high level the costs and benefit buckets have been identified, but the actual values in those areas needs further investigation when the details are defined. For example, the legal costs of a nationalisation vs full separation could be very different. Also the costs of either seem likely to outweigh the benefits unless related changes, such as removing the code administration from NGESO are also undertaken.

25. Do you think that the distribution of impacts is fairly represented, with impacted groups correctly identified? Outlined in table 5 of the IA.

As above, we need more details, but the headings look rights.

26. We invite respondents' views on whether the proposals for energy system governance reform may have a different impact on people who have a protected characteristic (age, disability, gender re-assignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex or sexual orientation), in different ways from people who don't have that characteristic.

We have no view on this.

Yours sincerely



pp Mark Draper
Chairman